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Cases, Regulations and Statutes

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majority shareholder in response to a request from a minority shareholder to cash out of the operation even though farmland values had increased roughly seven fold in the interim. It is hardly surprising that the Iowa Supreme Court held that the majority owner had acted "oppressively" and ordered appropriate relief.

Periodically renegotiated fixed price. Perhaps the most workable method of valuation is what has been termed the "periodically renegotiated fixed price."[6] With this approach, the bylaws, backed by a provision in the articles of incorporation (for a corporation) specifies that within a specified period after the close of the taxable year (typically 45 days), the board of directors (or shareholders) are directed to meet and agree upon the value for the stock for the coming 12-month period by setting a value on every asset held by the entity. Usually, commodity prices are readily obtainable from the local elevator or cooperative, farm equipment dealers are a convenient source for used farm machinery values, livestock are valued based on available market values and the land value is adjusted using surveys from dependable sources (often the state university).

But are such agreements to fix value upheld? The answer is in the affirmative. Some may recall that agreements of this nature before 1990 were used widely if four conditions were met – (1) the price was fixed or determinable by formula; (2) the estate, in the case of time of death valuations, was under an obligation to sell under a buy-sell agreement or upon exercise of an option;[7] (3) the obligation to sell was binding during life;[8] and (4) the arrangement was entered into for *bona fide* business reasons and not as a substitute for a testamentary disposition.[9] In 1990, a new section was added to the Internal Revenue Code, Section 2703,[10] which, at first glance, appeared to curb such agreements by specifying that, as a general rule, property was to be valued without regard to any option, agreement, restriction or "other right" which set price at less than the fair market value of the property.[11] However, the same section of the Internal Revenue Code specified that the general rule did not apply if the option, arrangement, restriction or "other right" met each of three requirements – (1) the arrangement was a *bona fide* business arrangement; (2) it was not a "device" to transfer value to family members for less than full consideration; and (3) the terms are comparable to "similar" arrangements entered into in an arm's length transaction.[12] A 2006 Tax Court decision[13] confirmed that the general rule did not apply where the three exceptions were satisfied. The *Amlie* case involved the stock valuation of a bank in Humboldt, Iowa.[14]

The experience has been, for those who have used the "periodically renegotiated fixed price" for several decades, that the required annual determination of value results in valuations which are respected by the owners (at the scheduled time for valuation, no one knows for sure who is going to die that year or even who may be wanting to sell or gift ownership interests that year) and the result is less conflict over valuations later when the occasion requires a determination of value because of death of an owner, gifting of ownership interests or sale of ownership interests.

ENDNOTES

[1] E.g., Duffy, "Iowa Land Value Survey," Iowa Agriculture and Home Economics Experiment Station, Iowa State University, Dec. 2013.

[2] See generally 2 Harl, *Farm Income Tax Manual* § 7.07 (2013 ed.).

[3] See Baur v. Baur Farms, Inc., 832 N.W.2d 663 (Iowa 2013).

[4] See 6 Harl, Agricultural Law § 52.02[5] (2013).

[5] Baur v. Baur Farms, Inc., 832 N.W.2d 663 (Iowa 2013).

[6] See 7 Harl, *Agricultural Law* § 52.02[5][c][vi] (2013).

[7] See, e.g., Estate of Littick v. Comm'r, 31 T.C. 181 (1958), *acq*., 1959-2 C.B. 5.

[8] See, e.g., Estate of Gannon v. Comm'r, 21 T.C. 1073 (1954).

[9] Estate of Gloeckner v. Comm'r, T.C. Memo. 1996-148, *rev'd,* 152 F.3d 208 (2d Cir. 1998) (restrictive agreement controlled valuation; testamentary purpose not behind agreement).

[10] Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11602(a), 104 Stat. 1388 (1990).

[11] I.R.C. § 2703(a).

[12] I.R.C. § 2703(b).

[13] Estate of Amlie v. Comm'r, T.C. Memo. 2006-76.

[14] *Id*.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

ADVERSE POSSESSION

EASEMENT. The plaintiff's predecessor in interest purchased 800 acres from the defendant. The deed granted an easement over the defendant's property for access to the property. Before the plaintiff purchased the property the defendant had constructed a fence on the boundary line in order to manage deer on the defendant's property and the fence enclosed the easement area. After the plaintiff purchased the property, the plaintiff attempted to use the easement but was prevented by the defendant. The defendant argued that the easement failed because the easement could not be located with reasonable certainty. The plaintiff provided aerial photographs over several years that agreed with the somewhat vague description in the deed. In particular, the photographs showed a gate in a location consistent with the description. The defendant claimed to have acquired the easement by adverse possession through the existence of the deer fence which enclosed the defendant's property, including the easement, and which was used for grazing. The court held that the construction of the fence was not a hostile possession of the easement because the defendant had no intention of claiming the easement as the defendant's sole property but intended only to use the fence to manage the deer on the property. **Shuhardt Consulting Profit Sharing Plan v. Double Knobs Mountain Ranch, Inc., 2014 Tex. App. LEXIS 592 (Tex. Ct. App. 2014)**.

BANKRUPTCY

GENERAL

DISCHARGE. The debtor had leased farm property which was used for hay production. The debtor's lease was terminated and the debtor ordered to vacate the property by a court order on March 26, 2012. On March 27, 2012, the debtor filed for Chapter 12 bankruptcy and On May 3, 2012, the debtor filed the bankruptcy schedules. The schedules included a claim for $135,000 resulting from the sale of hay to the plaintiffs sometime between March 27 and May 3, 2012. The hay was to come from the leased farm land. The plaintiffs filed a motion to convert the case to Chapter 7 on the basis of the debtor's fraud in selling them the hay and accepting a deposit for $135,000 without disclosing that the debtor had lost the property under court order and had filed for bankruptcy. The Bankruptcy Court held that conversion was required because of the debtor's fraudulent conduct. The present case involved a motion by the plaintiffs to have the $135,000 claim declared nondischargeable for fraud. Under Section 523(a)(2)(A), a debt is nondischargeable if obtained by fraud. The court looked at five elements of fraud: (1) misrepresentation, fraudulent omission or deceptive conduct by the debtor; (2) knowledge of the falsity or deceptiveness of his statement or conduct; (3) an intent to deceive; (4) justifiable reliance by the creditor on the debtor's statement or conduct; and (5) damage to the creditor proximately caused by its reliance on the debtor's statement or conduct. The court held that the prior ruling established the knowingly fraudulent conduct of the debtor in failing to disclose the lease termination and bankruptcy case. In addition, the prior ruling established sufficient facts to demonstrate the debtor's intent to deceive the plaintiffs in selling the hay and accepting the $135,000. Finally, the court held that the plaintiffs had demonstrated that they reasonably relied on the debtor and that they had clearly established the amount of damages to be the $135,000 paid. Thus, the court held that the debt was nondischargeable under Section 523(a)(2)(A). ***In re* Clark, 2014 Bankr. LEXIS 97 (Bankr. D. Idaho 2014)**.

FEDERAL TAX

DISCHARGE. The debtor filed for Chapter 13 in 2008 and sought to have federal taxes for 2000, 2001, 2002 and 2003 declared dischargeable. The IRS objected to the discharge of the 2000 and 2001 taxes for failure to file a return for those years and for 2000, 2001 and 2003 because the debtor willfully attempt to evade payment of those taxes. The Bankruptcy Court had denied motions by both parties for summary judgment on these issues, holding that a material issue of fact existed as to the debtor's intent. On appeal, the appellate court reversed, holding that summary judgment should have been entered for the IRS because the IRS present sufficient unrefuted evidence of the debtor's willful attempt to evade payment of the taxes in 2000, 2001 and 2003. **Reynolds v. IRS, 2014-1 U.S. Tax Cas. (CCH) ¶ 50,143 (D. Mass. 2014)**.

FEDERAL FARM PROGRAMS

CROP INSURANCE. The FCIC has adopted as final amendments to the General Administrative Regulations which revise regulations addressing ineligibility for programs under the Federal Crop Insurance Act. **79 Fed. Reg. 2075 (Jan. 13, 2014)**.

ORGANIC FOOD. The National Organic Program has announced the availability of a guidance document intended for use by accredited certifying agents, certified operations and non-certified handlers of certified organic products entitled *Certification Requirements for Handling Unpackaged Organic Products* (NOP 5031). **79 Fed. Reg. 3301 (Jan. 21, 2014)**.

FEDERAL ESTATE AND GIFT TAXATION

CHARITABLE REMAINDER TRUSTS. The IRS has issued proposed regulations providing rules for determining a taxable beneficiary's basis in a term interest in a charitable remainder trust (CRT) upon a sale or other disposition of all interests in the trust to the extent that basis consists of a share of adjusted uniform basis. The new rules are intended to prevent the following series of transactions that attempt to avoid recognizing gain from appreciated property in a CRT: Upon contribution of assets to the CRT, the grantor claims an income tax deduction under I.R.C. § 170 for the portion of the fair market value of the assets contributed to the CRT (which generally have a fair market value in excess of the grantor's cost basis) that is attributable to the charitable remainder interest. When the CRT sells or liquidates the contributed assets, the taxable beneficiary does not recognize gain, and the CRT is exempt from tax on such gain under I.R.C. § 664(c).The CRT reinvests the proceeds in other assets, often a portfolio of marketable securities, with a basis equal to the portfolio's cost. The taxable beneficiary and charity subsequently sell all of their respective interests in the CRT to a third party. The taxable beneficiary takes the position that the entire interest in the CRT has been sold as described in I.R.C. § 1001(e)(3) and, therefore, I.R.C. § 1001(e)(1) does not apply to the transaction. As a result, the taxable beneficiary computes gain on the sale of the taxable beneficiary's term interest by taking into account the portion of the uniform basis allocable to the term interest under Treas. Reg. §§ 1.1014-5 and 1.1015-1(b). The taxable beneficiary takes the position that this uniform basis is derived from the basis of the new assets acquired by the CRT rather than the grantor's basis in the assets contributed to the CRT. In an attempt to prevent such abuses, the proposed regulations provide a special rule for determining the basis in certain CRT term interests in transactions to which I.R.C. § 1001(e)(3) applies. In these cases, the proposed regulations provide that the basis of a term interest of a taxable beneficiary is the portion of the adjusted uniform basis assignable to that interest reduced by the portion of the sum of the following amounts assignable to that interest: (1) the amount of undistributed net ordinary income described in I.R.C. § 664(b)(1); and (2) the amount of undistributed net capital gain described in I.R.C. § 664(b)(2). These proposed regulations do not affect the CRT's basis in its assets, but rather are for the purpose of determining a taxable beneficiary's gain arising from a transaction described in I.R.C. § 1001(e)(3). However, the IRS and the Treasury Department may consider whether there should be any change in the treatment of the charitable remainderman participating in such a transaction. **79 Fed. Reg. 3142 (Jan. 17, 2014)**.

DISCLAIMERS. The donor executed an irrevocable trust prior to January 1, 1977. Under the trust, the trustees are to pay such sum or sums from time to time out of the income, accumulated income, or principal to or for the benefit of the donor's child or any of the child's descendants, in the trustees' sole and absolute discretion in the event of illness, accident, other misfortune, or any emergency, or if in the trustees' judgment, it is necessary to provide for the beneficiaries' comfortable maintenance, support, or education. The trust will terminate 20 years after the death of the survivor of all of the donor's descendants living on the date of execution of the trust. On termination, the remaining trust principal and undistributed income will be distributed to the descendants of the child who have no living ancestor who is a descendant of the child per stirpes. On the date the trust was executed, the donor had 11 living descendants consisting of three children and eight grandchildren, all of whom are still living. The taxpayer was a grandchild of the donor's child and was one of the beneficiaries to whom the trustees could, in their discretion, make current distributions of income and principal. The taxpayer had not received any discretionary distributions from the trust but the taxpayer would be entitled to receive a per stirpes portion of the trust remainder, if the taxpayer survives until the termination of the trust. Within nine months after attaining majority, the taxpayer disclaimed the contingent right to receive any distribution from trust on termination of the trust. Under Treas. Reg. § 25.2511-1(c), if the interest to be disclaimed was created before January 1, 1977, the disclaimant must disclaim the interest in the property within a reasonable time after knowledge of the existence of the transfer creating the interest to be disclaimed. The IRS ruled that, assuming the disclaimer meets the requirements of Treas. Reg. § 25.2511-1(c), the disclaimer would not constitute a transfer subject to federal gift tax. **Ltr. Rul. 201403005, Sept. 19, 2013**.

INSTALLMENT PAYMENT OF ESTATE TAX. The decedent's estate included the decedent's interest in general partnerships, limited liability companies (LLC) and corporations. At the time of the decedent's death, the decedent and partner held commercial real estate real property interests as tenants-in-common as nominees for one of the general partnerships. This business arrangement constituted more than 50 percent of the value of all business interests held by the estate. The estate made the I.R.C. § 6166 election to defer payment of federal estate tax attributable to the decedent's interests in the general partnerships, LLCs, and corporations. The estate and the partners distributed each of the properties in the business arrangement to separate LLCs with the estate and partner each receiving the same interest in the LLCs. The LLCs continued the same business arrangement with each party maintaining the same share of the business. The IRS ruled that the distribution of the business properties to the LLCs did not cause acceleration of the installment payments of estate tax. The Digest will publish an article by Neil Harl on this ruling in the next issue. **Ltr. Rul. 201403012, Sept. 25, 2013**.

FEDERAL INCOME TAXATION

CASUALTY LOSSES. The taxpayer claimed a casualty loss for a car damaged in an accident. The taxpayer purchased the car for $60,020 in 2006 and received $47,950 from the insurance company after the accident in 2008. The taxpayer claimed the difference as a casualty loss deduction. The court held that the deduction was properly disallowed because the taxpayer provided no evidence of the value of the car just before the accident and just after the accident. **Douglas v. Comm'r, T.C. Summary Op. 2014-7**.

DISASTER LOSSES. On January 6, 2014, the President determined that certain areas in Alaska are eligible for assistance from the government under the Disaster Relief and Emergency Assistance Act (42 U.S.C. § 5121) as a result of a severe winter storm which began on December 5, 2013. **FEMA-4150-DR**. Accordingly, taxpayers in the areas may deduct the losses on their 2012 or 2013 federal income tax returns. See I.R.C. § 165(i).

DOMESTIC PRODUCTION DEDUCTION. The Office of Chief Counsel has issued an informal generic legal advice memorandum on the issue of whether co-operative advertising allowances that retailers of inventory receive from vendors of products for placement of advertisements of vendors' products in retailers' flyers may be treated as domestic production gross receipts for purposes of I.R.C. § 199. The IRS ruled that the co-operative advertising allowance would be domestic production gross receipts where the allowance is treated as separate income from offering advertising services. However, the allowance is not domestic production gross receipts where the allowance is intended to reduce the cost of the items advertised. **AM-2014-001, Jan. 14, 2014**.

EMPLOYEE EXPENSES. The taxpayer was employed full time as an air traffic controller and worked part time for several companies in sales. The taxpayer claimed travel deductions for travel to meetings and seminars related to the sales activity. The taxpayer also claimed deductions for job expenses and certain miscellaneous deductions on Schedule A. The court held that the travel deductions relating to the sales seminars and meetings were allowed to the extent the taxpayer provided written receipts. The court held that the deductions for travel and training related to the full time employment were not allowed because the travel and training were not required for employment. The court disallowed a deduction for union dues for lack of substantiation. **Douglas v. Comm'r, T.C. Summary Op. 2014-7**.

FILING STATUS. The taxpayers, husband and wife, were Somali immigrants. The wife had four children by a prior marriage to the deceased half-brother of the husband. The taxpayers used a tax return service which had employees who spoke Somali to file their 2011 return. The husband used the filing status of head of household and the wife used the status of single. The husband claimed two of the children as dependents. The IRS ruled that the husband was only entitled to use married filing separately status. The husband argued that he should be allowed to filed an amended return using married filing jointly status. The court held that I.R.C. § 6013(b)(2)(B) barred the husband from filing an amended return using the married filing jointly status because the husband originally filed with a "separate return" of head of household status. The court also held that the taxpayer could not claim the earned income credit because the credit was available only to taxpayers filing with the married filing jointly status. **Ibrahim v. Comm'r, T.C. Memo. 2014-8**.

INCOME. The taxpayers, husband and wife, operated a trucking business. The IRS assessed tax deficiencies based on reconstruction of the business income from bank records. The IRS also disallowed deductions for car and truck expenses. The taxpayers argued that the use of the bank records to determine taxable income should be disallowed because the taxpayer had shown that there were several errors. The taxpayers attempted to prove the car and truck expenses by written invoices. The Tax Court held that the taxable income was properly determined using the bank records once the errors were corrected and the deductions were properly disallowed for lack of substantiation where the taxpayers failed to prove that the invoices were paid. On appeal, the appellate court affirmed. **Burley v. Comm'r, 2014-1 U.S. Tax Cas. (CCH) ¶ 50144 (6th Cir. 2014), *aff'g*, T.C. Memo 2011-262.**

INNOCENT SPOUSE RELIEF. The taxpayer and former spouse had filed jointly for many years. The couple separated in 2009 but, on advice of attorneys, the couple agreed to file a joint return for 2009. The taxpayer provided the spouse with tax information and the spouse prepared the form. However, in 2009, the taxpayer failed to include W-2 forms because the form were sent out late. The spouse failed to communicate with the taxpayer and filed the return electronically without including the taxpayer's income listed on the W-2 forms, resulting in an underreporting of income. The taxpayer was not given a chance to review the return. The error was discovered in late 2010 but the taxpayer did not file an amended return. After the IRS assessed the missing taxes, the taxpayer filed for innocent spouse relief. The court denied equitable innocent spouse relief because the tax deficiency was solely attributable to the taxpayer's income. The taxpayer argued that a fraud exception applied because the spouse filed the return without the taxpayer's signature. The court disagreed, noting that the taxpayer knew that the return was filed with incomplete information provided by the taxpayer and after the taxpayer learned about the underreporting, the taxpayer failed to take effective steps to file an amended return. **Zimmerman-Phillips v. Comm'r, T.C. Summary Op. 2014-8**.

NET INVESTMENT INCOME TAX. Commerce Clearing House reported on talks by attorneys with the Office of the Associate Chief Counsel Office stating that taxpayers may report 2013 net investment income tax under the 2012 proposed regulations, the 2013 proposed regulations or the 2013 final regulations without informing the IRS as to which regulations were being used. The article states that the speakers indicated that, when the final Form 8960, *Net Investment Income Tax - Individuals, Estates and Trusts*, and instructions are issued, they will be applicable to 2013 and subsequent years. **Federal Tax Day - Current, I.7, "Taxpayers Reporting Net Investment Income Tax Can Use Both Proposed and Final Regulations, IRS Officials Say," (Jan. 14, 2014).**

PARTNERSHIPS

ADMINISTRATIVE ADJUSTMENTS. In a short Chief Counsel Advice letter, the IRS stated, "We can issue an FPAA if any partner's section 6501 statute is open. If it is open due to a Form 872, the Form 872 must specifically reference partnership items as required by section 6229(b)(3). Since about 2008, the standard Form 872 contains such language. . . . In short, section 6501(a) provides the period of limitations for assessing any tax imposed by Title 26 of the United States Code, including tax attributable to partnership and affected items. . . . [citation omitted]. This period runs from the filing date of an actual tax return rather than from the filing date of a pass-through entity information return (such as a partnership return). As referenced in section 6501(n), section 6229 merely extends each partner's section 6501 period. Section 6229(a) provides that each partner's section 6501 assessment period for tax attributable to partnership and affected items shall not expire before the date that is three years after the later of the date on which the partnership return for the taxable year was filed, or the last day for filing the return for that year (determined without regard to extensions). . . [citations omitted]. Thus, section 6229 operates only to extend a partner's section 6501 period. It does not shorten the partners' otherwise applicable period for assessment. So if any partner's section 6501 period is open for partnership items, we may issue an FPAA that is binding on that partner. I.R.C. 6226(d)(1)(A)." **CCA 201402009, Aug. 29, 2013**.

BUILT-IN LOSSES. The IRS has issued proposed regulations that would implement I.R.C. § 704(c)(1)(C), added by the American Jobs Creation Act of 2004 (Pub. L. 108-357) for contributions of built-in loss property to partnerships after October 22, 2004. I.R.C. § 704(c)(1)(C) provides that a contributing partner's built-in loss is only taken into account in determining the partner's share of partnership items. The provision was intended to prevent partners from transferring losses to other partners in the partnership or to a transferee partner who purchased or otherwise acquired the contributing partner's partnership interest. I.R.C. § 704(c)(1)(C) provides that, if property contributed to a partnership has a built-in loss: (i) the built-in loss is taken into account only in determining the amount of items allocated to the contributing partner, and (ii) in determining the amount of items allocated to other partners, the basis of the contributed property in the hands of the partnership is equal to its fair market value at the time of the contribution, except as provided in regulations. The proposed regulations state that a I.R.C. § 704(c)(1)(C) basis adjustment is initially equal to the built-in loss associated with the I.R.C. § 704(c)(1)(C) property and then is adjusted in a generally similar manner to basis adjustments required by the I.R.C. § 743 regulations. If a partnership transfers I.R.C. § 704(c)(1)(C) property, the contributing partner's I.R.C. § 704(c)(1)(C) basis adjustment is taken into account in determining its income, gain, loss, deduction, or credit from the sale or exchange of the property. If the property is transferred in a nonrecognition transaction, the partner retains the I.R.C. § 704(c)(1)(C) basis adjustment in the substituted basis property received in exchange. The proposed regulations provide an anti-abuse rule, under which, if a principal purpose of a transaction is to avoid the application of the substantial built-in loss rules with respect to a transfer, the IRS can recast the transaction as appropriate to achieve tax results that are consistent with the purpose of the provisions. **79 Fed. Reg. 3041 (Jan. 16, 2014)**.

QUALIFIED JOINT VENTURE. In a short Chief Counsel Advice letter, the IRS stated, "I agree with your instinct that the business income should have been reported on a Schedule C. You ask whether a Schedule C can be jointly operated. An unincorporated business jointly owned by a married couple is generally classified as a partnership for federal tax purposes. However, for tax years beginning after December 31, 2006, the Small Business and Work Opportunity Tax Act of 2007 (Public Law 110-28) provides that a "qualified joint venture", whose only members are a husband and a wife filing a joint return, can elect NOT to be treated as a partnership for Federal tax purposes. Both spouses can still get social security credit if they elect for the business to be treated as a qualified joint venture. Spouses make the election on a jointly filed Form 1040 by dividing all items of income, gain, loss, deduction, and credit between them in accordance with each spouse's respective interest in the joint venture, and each spouse filing with the Form 1040 a separate Schedule C. The taxpayers probably should have done this. I agree that the only way they would owe FICA is if one spouse is the employee of the other spouse, and then only the employee spouse's wages would be subject to FICA." **CCA 201402004, April 25, 2013**.

TAX MATTERS PARTNER. In a short Chief Counsel Advice letter, the IRS stated, "Dissolution of the TMP terminates TMP status. So if the designated TMP dissolved, its designation terminated. Since both direct partners dissolved, we can designate an indirect partner as TMP under Treas. Reg. 301.6231(a)(7)-1(n) and (p)." **CCA 201402014, Dec. 11, 2013**.

PENSION PLANS. For plans beginning in January 2014 for purposes of determining the full funding limitation under I.R.C. § 412(c)(7), the 30-year Treasury securities annual interest rate for this period is 3.80 percent. The 30-year Treasury weighted average is 3.46 percent, and the 90 percent to 105 percent permissible range is 3.12 percent to 3.64 percent. The 24-month average corporate bond segment rates for January 2014, without adjustment by the 25-year average segment rates are: 1.25 for the first segment; 4.06 for the second segment; and 5.08 for the third segment. The 24-month average corporate bond segment rates for January 2014, taking into account the 25-year average segment rates, are: 4.43 for the first segment; 5.62 for the second segment; and 6.22 for the third segment. **Notice 2014-8, I.R.B. 2014-5**.

REPAIRS. The IRS has issued a revenue procedure which modifies *Rev. Proc. 2012-19, 2012-1 C.B. 689* and sets forth procedures by which a taxpayer may obtain the automatic consent of the Commissioner to change the taxpayer's method of accounting provided in Temp. Treas. Reg. §§ 1.162-3T, 1.162-4T, 1.263(a)-1T, 1.263(a)-2T, and 1.263(a)-3T for taxable years beginning on or after January 24, 2014. This change applies to a taxpayer who wants to change from capitalizing under I.R.C. § 263(a) amounts paid or incurred for tangible property to deducting these amounts as repair and maintenance costs under I.R.C. § 162 and Treas. Reg. § 1.162-4T. This revenue procedure also modifies the procedures by which a taxpayer may obtain the automatic consent of the Commissioner to change to a reasonable method described in Treas. Reg. § 1.263A-1(f)(4) for self-constructed assets and to change to a permissible method of accounting under I.R.C. § 263A(b)(2) and Treas. Reg. § 1.263A-3(a)(1) for certain costs related to real property acquired through foreclosure, by deed in lieu of foreclosure, or in another similar transaction. Finally, the revenue procedure modifies the change of method of accounting for taxpayers in the business of transporting, delivering, or selling electricity. **Rev. Proc. 2014-16, I.R.B. 2014-7**.

SAFE HARBOR INTEREST RATES
February 2014

	Annual	Semi-annual	Quarterly	Monthly
		Short-term		
AFR	0.30	0.30	0.30	0.30
110 percent AFR	0.33	0.33	0.33	0.33
120 percent AFR	0.36	0.36	0.36	0.36
		Mid-term		
AFR	1.97	1.96	1.96	1.95
110 percent AFR	2.17	2.16	2.15	2.15
120 percent AFR	2.36	2.35	2.34	2.34
		Long-term		
AFR	3.56	3.53	3.51	3.50
110 percent AFR	3.92	3.88	3.86	3.85
120 percent AFR	4.28	4.24	4.22	4.20

Rev. Rul. 2014-6, I.R.B. 2014-7.

S CORPORATIONS

ELECTION. The taxpayer filed an election to be treated as an S corporation. After a regulator refused to allow distributions, the taxpayer transferred shares to an ineligible shareholder, causing the S corporation election to terminate. The IRS denied the taxpayer's request to file a new S corporation election less than five years after the termination of S corporation status because the taxpayer voluntarily terminated the first election. **Ltr. Rul. 201403001, Sept. 17, 2014**.

TRADE OR BUSINESS. The taxpayers, husband and wife, purchased 88 acres of undeveloped land and in 2003 decided to develop the land into residential building lots. Over the next several years, through 2009, the taxpayers developed plans with a land use company to obtain county approval for the development. For 2009 the taxpayers claimed Schedule C expense deductions relating to legal and professional services incurred by the hiring of land use professionals and for amounts paid in escrow to the county for their "Land Developing and Subdivision" activity. The taxpayers also claimed deductions for car and truck expenses, meal and entertainment expenses, depreciation expenses, and home office and advertising expenses related to the land development project. The IRS disallowed the deductions because the taxpayers were not engaged in a trade or business. The expenses were deemed capital expenditures. The IRS argued that a trade or business did not exist because the taxpayer did not have an existing real estate developing business when they started this activity, the property was not developed as of 2009, no lots had been sold by 2009 and the taxpayers had no profit from the activity. The court agreed with the IRS, noting that all of the taxpayers' activities were devoted to planning the development and no efforts were made, as of 2009, to market the lots. The taxpayers also argued that they were entitled to take the deductions under I.R.C. § 165(a) because they had abandoned the activity. The IRS argued that the abandonment provision was not applicable because the taxpayers failed to prove that they had completely abandoned the activity, that the property did not have value and that the taxpayers would not restart development in the future. Again the court agreed with the IRS, noting that the taxpayers had written to the IRS that they intended to restart development if the economy and housing markets revived. **Chen v. Comm'r, T.C. Summary Op. 2014-6**.

INSURANCE

POLLUTANT. The plaintiffs owned and operated a dairy farm and cattle ranch. The defendants operated a septic pumping service and purchased a business liability insurance policy. The septage included farm and human waste and materials from tanks, grease traps, floor pits and car washes. The policy expressly excluded losses resulting from the "discharge, dispersal, seepage, migration, release, or escape of 'pollutants' into or upon land, water, or air" and "any loss, cost, or expense arising out of any ... claim or suit by or on behalf of any governmental authority relating to testing for, ... cleaning up, removing, ... or in any way responding to or assessing the effects of 'pollutants.'" Pollutant is defined in the policy as "any solid, liquid, gaseous ... irritant or contaminant, including ... waste. Waste includes materials to be recycled, reclaimed, or reconditioned, as well as disposed of." The plaintiffs agreed to have the defendants spray the septage on their pastures. After some time, the plaintiffs discovered that the septage had resulted in elevated concentrations of nitrates in the plaintiffs' well water, causing the death of cattle. The plaintiffs filed suit in negligence and nuisance and included the defendant's insurance companies. The insurance companies argued that septage was a pollutant excluded from coverage under their policies. The court agreed, holding that no reasonable insured would expect that "pollutant" did not include "waste." Note, *Wilson Mutual Ins. Co. v. Falk, 2013 Wisc. App. 1031 (Wis. Ct. App. 2013)* summarized in 25 *Agric. L. Dig.* 6 (2014) came to a different conclusion, although that case involved only cattle waste and human waste, and grease and oil trap waste. **Preisler v. Kuettel's Septic Service, LLC, 2014 Wisc. App LEXIS 18 (Wis. Ct. App. 2014)**.

TRUSTS

MEDICAID. The plaintiff was an estate of a decedent who had died seven years after the decedent's spouse. The couple had created an irrevocable trust which was funded with their interests in their farm. The trust provided for net income to be distributed to the couple and that, at the death of either grantor, the trust was to pay any debts of the decedent. The spouse received Medicaid assistance for two years before she died. The husband also received Medicaid benefits for several years before he died. At the death of the spouse the Iowa Department of Human Services Estate Recovery Program (the Program) ruled that the spouse's estate had no assets from which the Program could recover Medicaid payments. However, at the death of the husband, the program ruled that the trust assets were liable for recovery of the Medicaid payments received by both decedents. The trial court had ruled against the Program because the trust was responsible only for the debts of the decedents and not the debts of the decedents' estates. The appellate court reversed, holding that, because the decedents had an interest in the trust, the trust was reachable by the Program. The court considered the trusts liability for the decedents' debts an interest in the trust. In addition, the court held that Iowa Code § 249A.5(2) made the Medicaid recovery liability a personal debt of the decedents, thus a debt provided for in the trust agreement. ***In re* Melby, 2014 Iowa Sup. LEXIS 3 (Iowa 2014)**.

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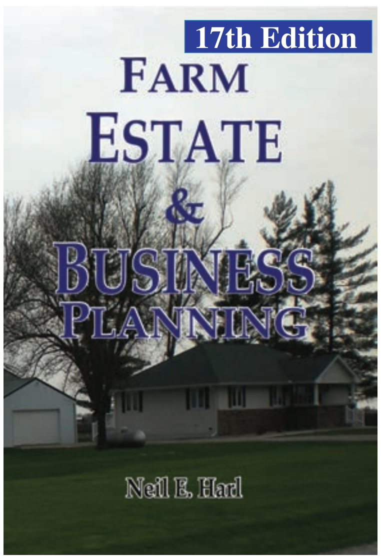

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